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ADDRESS

BY THE PRESIDENT OF THE FACULTY OF ACTUARIES

PAUL HENRY GRACE, B.Sc., F.F.A.

[Delivered to the Faculty of Actuaries, 14 October 1996]

ABSTRACT

The first part of the Address is a review of changes over the last 30 years in the actuarial management of a life office — ranging from the introduction of the Appointed Actuary system to some of the consequences of the Financial Services Act. It draws attention to some of the differences in the regulatory treatment of life assurance companies and other competing organisations in the savings field, highlights some of the shortcomings in the European solvency regime that is currently being reviewed by the authorities, comments on developments in the area of anti-discriminatory legislation and draws attention to some possible problems arising from such legislation.

The Address continues by outlining some of the issues that must be tackled if the profession is to expand into other fields, and the last part comments on developments in the day-to-day management of the United Kingdom actuarial profession and the Faculty's relationship with the Institute.

KEYWORDS

Appointed Actuary; Guidance Notes; Solvency; Discrimination; Financial Services Act; Encroachment

I would like to begin by thanking you for electing me President, an honour I had never expected to receive. I am conscious that I came originally from south of the border, although I am not the first such 'foreigner' to occupy this post! I received the latter part of my formal education in Scotland and am conscious of the high standards in this area. During my term of office I will do my best to uphold the traditions of the Faculty in these days of change.

I have been influenced over the years by many members, far too numerous to mention by name; however, I would like to make one exception, namely Mr I. Isles, whom I first met in 1959; and without whose encouragement I would not be standing here today. Until that encounter I had not heard of an actuary, let alone known what he (or she) did. The quality of career advice in the mid 1950s was minimal compared to that now given to school leavers; despite my mathematical ability I had been advised at school to follow a career in chemistry, and accordingly, when I enrolled at Queen's College, Dundee (at that time part of St. Andrew's University), it was to follow a chemistry course. I soon realised my mistake, and after my first year I switched to mathematics with the thought that, if necessary, I could teach. Fortunately one of our lecturers had been at school with Mr Isles, and he invited him to address the honours mathematics class. Mr Isles's enthusiasm for an actuarial career convinced me and a fellow student to join his office and to enrol as students with the Faculty. I believe that we were the first two St. Andrew's University graduates to qualify as Fellows, and to whom one of my predecessors, Professor J. J. McCutcheon, made reference in his Address. I will always remain indebted to Mr Isles for the advice he gave me almost 38 years ago. Incidentally, between us making our decision and taking up employment, the profession had its best ever recruitment publicity in the form of the publication of the report of the Royal Commission on Doctors' and Dentists' pay (to which Mr D.A.B. Scrimgeour referred in his Address in 1960), and which demonstrated that the actuarial profession was well remunerated.

I suspect that one of the first thoughts of my predecessors, after they had been approached and agreed to accept nomination for this office, would have been their Address. This was certainly true for me. I was conscious that it has been the custom that a Presidential Address should not raise controversial issues — the reason being that the occasion does not give the opportunity for members to express their own views on the issues. My predecessor, Mr G.M. Murray, departed from this practice when he raised the issue of the Future Structure of the Actuarial Profession in the United Kingdom. However, in doing so he said that he would arrange for a suitable opportunity for views to be expressed, and in due course a discussion took place at a special closed meeting in March 1995. One outcome of these discussions has been the decision to work more closely with the Institute; I will revert to the detail of this change later. It has been the practice of Institute Presidents, certainly in recent years, to mention in their Presidential Addresses certain objectives that they would like to see achieved during their term of office. Many of these objectives have been translated into tasks to be debated and executed by what were Joint Committees, but which, two years ago, became Joint Boards. Thus, the Faculty has played its part in carrying out objectives set by the Institute's President. Given the *modus operandi* that now prevails, it seems not unreasonable, therefore, that I should pose some questions in the course of my address, which might, in due course, be picked up by Councils or the various boards for further discussion.

Whilst giving thought to my Address, not surprisingly, I looked back to earlier addresses and was struck by the number of issues that kept recurring. Amongst those which I read was the Address given by the previous actuary to hold this office who was employed by the organisation with which I am associated. (I choose my words carefully, because many actuarial employers have undergone structural changes in the intervening period!) I refer to the Address by Mr C. Guthrie. If we were still able to hold this meeting in our own Hall, many of you would now be studying a board over my shoulder and would note that he held office for two years commencing in 1928. At that time the Faculty was based in Queen Street and was still to admit its first female as a Fellow — although there were about ten ladies enrolled as students, including three at Mr Guthrie's office. In his Address he made several references to issues that might be considered topical in more recent years. He advocated closer co-operation with the Institute of Actuaries, in particular the adoption of common examinations — in order, amongst other things, to lighten the labour of preparing examination papers. He suggested the possibility of one journal common to both bodies. He also referred to a report from a special committee formed by the Institute to consider the future of the actuarial profession in the U.K.; that committee concluded that it was possible to enlarge the scope of the profession in connection with all spheres of business calling for the use of modern statistical methods. These issues on co-operation took almost seventy years to come to fruition, and with regard to the third, not only are we still striving to broaden our sphere of operations into other wider fields, but we spent time last session discussing a further report on the future of the profession, another issue to which I will refer later. Fortunately this does not imply that there have been no developments within the profession since 1928. These are some issues where it was probably as well to *make haste slowly.*

To revert to the subject for my Address, it certainly taxed me. My career has always been with an insurance company, and predominantly in the actuarial management of the life funds, although not always with the same company — I changed employers shortly after qualifying. Whilst in that employment I gained some experience in the non-life sector, as we chose, at that time, to refer to general insurance. In due course I returned to my original employer. Given that most of my career has been spent as an Appointed Actuary, and also that in recent years I have been deeply involved with the Faculty and Institute's Life Board (and its predecessor), I decided to devote part of my Address to a review of some of the changes that have taken place in the domain of the Appointed Actuary, and to mention some issues where there might be further developments in the foreseeable future

I was first appointed, I stress with a small 'a', actuary of a company at the age of 27. Although quinquennial actuarial investigations had to be made in respect of life assurance funds and the reports filed with the Board of Trade (as the DTI was then called), there was no need for a company to have an Appointed Actuary. This requirement came with the 1972 Insurance Companies Act. If that legislation had been in place a few years earlier I would obviously have been ineligible on age grounds — in any event whether I was 'fit and proper' was probably debatable!

The 1972 Act also saw a move from quinquennial to triennial valuations, a move facilitated by the developments of electronic data processing. Whilst the available computing power was a considerable improvement on the punched card systems used previously, valuations still took an inordinate amount of time, and it was not really practical to produce accurate results on a variety of bases and methods.

There had been noticeable changes in products during the 1960s. The steady move from fixed-interest investments in favour of equities for with-profits business had encouraged new companies to enter the market and offer unit-linked products. Increasing computer power facilitated this product development. Terminal bonus systems were introduced by some companies, ostensibly to enable unrealised capital appreciation to be distributed — personally, I could never see the difference between unrealised and realised capital profits. Guaranteed bonds were introduced at the beginning of the 1970s, initially taking advantage of certain anomalies in the tax system — things do not change.

The economic shocks of 1973/74 created problems for which solutions had to be

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found, and resulted in the first guidance from the profession, when, in May 1975, Councils published a Guide entitled 'Actuaries and Long-Term Insurance Business', that was to become GN1. This document was the subject of a discussion at a Sessional Meeting early in 1976, at which it was welcomed by some members, while there were others who felt it was unnecessary and that its contents reflected simply the application of common sense. There are a number of actuaries who regret the proliferation, since then, of Guidance Notes, either on similar grounds to the original sceptics or because they believe that Guidance Notes duplicate legislation, official or quasi, or, in some instances, because the authorities should handle the issues themselves through suitable legislation. Where the legislators' objective can be easily achieved by straightforward legislation, I do not think that we should do the job for them. On the other hand, I can see merit in some technical issues being dealt with through GNs rather than through legislation. This is particularly true with any concepts which are still, to some degree, in the course of development, and where, with the benefit of experience, change might be required, although some people question whether the profession is able to expedite changes more efficiently than the authorities.

The fact that GNs are recognised in legislation is a credit to the Faculty and Institute as self regulatory bodies, and attracts favourable comment from outside our profession. It must be better that we can set our own standards rather than place them in the hands of the government or some other organisation over whom our members have no control.

There has been a tendency when developing GNs to incorporate, not only the core requirements of the profession, but also further material that is more in the nature of illustration or example. In other cases, in an endeavour to cover all possible scenarios, the profession has included some points in GNs that will rarely apply in practice. This has been particularly true in the case of some of the former 'Advisory' or 'Best Practice' GNs that became 'Recommended Practice', following the publication, earlier this year, of the *Manual of Actuarial Practice*. We should revisit our GNs to check whether they are wholly mandatory or recommended practice, and, if there is some text that does not satisfy these descriptions, consider whether it should be dropped altogether or retained, possibly as 'explanatory text'.

The development of new contracts, partly facilitated by the increased computing power, led also to the development of new techniques. Studies were undertaken into the basis of reserving for unit-linked business and the reserves to be established for unit-linked contracts that incorporated maturity guarantees; the derivative products now available, and that back such products now, were unheard of at that time. Against the background of an increasing proportion of assets in equity-type investments, some companies had started to move away from the traditional net premium valuation towards some form of gross premium or bonus reserve valuation approach.

Developments within Europe led to the application, in 1982, for the first time in the U.K., of a minimum solvency valuation basis. The legislation pointed towards a net premium approach, but with the actual basis determined by the individual

Appointed Actuary. Although other approaches were to be permitted, the company had to be able to demonstrate that the reserves established were no less than they would be on the statutory basis. I have no doubt that, inwardly, many Appointed Actuaries resented this development, which imposed some constraints on their judgement. This was followed in 1984 by what has become known as the European Union Solvency Margin.

In his address in 1979, Mr D. D. McKinnon, who was at that time a member of the Groupe Consultatif, the association of European actuarial bodies in which both the Faculty and the Institute play a full part, drew attention to the discussion that had preceded the introduction of the E.U. Solvency Margin — in particular that the U.K. life assurance industry thought that it should be possible for all the margins inherent in the statutory valuation bases to count automatically towards the required solvency margin. This was not to be, although the U.K. and Irish delegates entered a reservation on the point at the meeting of the Council of Ministers at which the Directive was adopted. Mr McKinnon went on to say that he hoped that in future our country's delegates would not waver in their adherence to this conviction. Four years later Mr A. D. Shedden said that, in his view, the solvency margin requirements represented an insensitive standard of dubious actuarial validity, which, in the context of the valuation regulations, was arguably superfluous.

It is interesting to observe that some two years ago the European Commission embarked on a review of the Solvency Margin regime and established a working party which is due to report next year. Not surprisingly, the Groupe Consultatif is making a submission — at the present time it has not been finalised — but views not dissimilar to those expressed by Mr Shedden have been made by the delegates; the Dutch actuaries, in particular, have been pressing the point made by the U.K. delegates on the earlier occasion, namely that margins in the valuation basis should be allowed to count towards the required solvency margin.

Mr McKinnon also expressed the view that there was a real danger that our traditional methods would not be acceptable when the Freedom of Services Directive came to be negotiated. Such views were widely held by U.K. actuaries. There was also concern, on commercial grounds, that the freedom to develop competitive and innovative products would be inhibited. The slogan in the U.K. for many years had been 'Freedom with Publicity' — a freedom that both actuaries and the life assurance companies we served wished to protect. In comparison, many of our European counterparts worked within constraints imposed by their national governments.

The Groupe Consultatif made a submission that companies should establish reserves on a basis that satisfied a set of actuarial principles. With only minor variations those proposals were accepted by the Commission, and were reflected in the Third Life Directive. Member States had until July 1994 to amend their legislation to conform with the Directive, although several Member States were given an extension. In due course the U.K. Government adopted new regulations. The profession having made input through its membership of the Joint Actuarial Working Party (JAWP), a group consisting of representatives of the DTI, the Government Actuary's Department and the profession. These Regulations involved minimal change for U.K. companies compared with the requirements in most of Europe.

JAWP also established some working parties to study other issues, amongst them 'An Alternative to the Net Premium Valuation'. That working party produced a paper that was discussed by both the Faculty and the Institute earlier this year. Whilst arguments were put forward to support a gross premium method for conventional business, these arguments did not gain universal support for traditional with-profits business. There were clearly some doubts about the valuation methods for unitised with-profits business, which, for some companies, bears little resemblance to conventional with-profits business beyond the periodic declaration of bonuses. Two working parties established to study valuation methods for unit-linked business reported in 1978 and 1988 respectively, and pointed the way towards acceptable standards for unit-linked business. These have, by and large, been followed, and the supervisors have not felt it necessary to seek to impose any specific legislation on that class of business, relying instead on the professional judgement of the actuary.

As many of us would wish to avoid the constraints of legislation as far as possible, it would seem sensible for the profession to seek specifically to establish similar acceptable standards for unitised with-profits business. The working party, whose paper, as mentioned a moment ago, was discussed earlier this year, made a start on the issue, and it is hoped that a standard can soon be established. In their report they referred to constraints resulting from the E.C. Directive — I do not believe that Directives should be viewed as set in tablets of stone. The principles recommended by the Groupe Consultatif reflected the then current practice; if contract developments dictate a change in principles, appropriate representations should be made to the European Commission, preferably with the support of the Groupe Consultatif. We would be failing in our duty if we stood by and allowed inappropriate valuation methods to be applied solely because of the Life Directives. Likewise, the E.C. Directives should not constrain the development of new contracts.

I mentioned, a moment ago, our duty, and I would like to make a few observations on the subject of public interest. They are not dissimilar to the thoughts expressed by some members some 20 years ago on the subject of guidance, to which I referred earlier. Basically, actions of a professional body and its members should naturally be in the public interest — and special guidance should not be considered necessary. The words do, however, feature in the profession's Strategic Aims, adopted by Councils some five years ago when the Mission Statement was published, and also in our Memorandum on Professional Conduct.

A self regulating professional body, such as the Faculty, should have regard to the public interest in setting standards — if it does not, it will forfeit its right to be considered a professional body; but it is for the members to carry that through into practice, even when there is nothing explicit in the profession's guidance.

There was a time when our members would believe that their actions were in the public interest; the public would not question their decisions. The same could be said of other professions — their members were respected by the lay public. Encouraged by the media, the public have become more questioning and more demanding. Members now need to assess consciously whether, in their work, they are having regard to the public interest. This is not the same as each individual member of the public agreeing that our actions are in his or her best interests. We should learn from recent experiences. For example, there is nothing wrong with personal pensions as a concept — in fact, in as much as they encourage people, who would not otherwise have done so, to make provision for their retirement, they are positively good and in the public interest. This is not the same as saying that personal pensions are in everyone's interests — in fact, where individuals are encouraged to leave good occupational pension schemes in order to effect personal pensions, the converse is more likely to be the case.

One area of public interest that affects our profession is that of discrimination. There are increasing social pressures not to discriminate in life generally — reflected in several pieces of legislation. The insurance industry has been exempt from much of this legislation. Insurance companies could not operate in a free market if they were not allowed to discriminate. Take, for example, motor insurance. Currently insurers categorise risks according to a number of factors, for example driving experience, accident record, location of residence, size of vehicle. If the companies were not allowed to discriminate, the same premium would be charged for all risks and the cost for the low risk categories would increase. People in such a category would seek self insurance by restricting cover purchased to the minimum required by the Road Traffic Acts. This would push up the cost for those seeking cover beyond that required by legislation, with the ultimate result that only the heaviest risks are insured.

Annuity rates both unisex and unistate, that is independent of marital status, were imposed in 1988 on the life assurance companies for a compulsory sector, namely annuities to be purchased by protected rights benefits. From an actuarial perspective this was an acceptable development, because of the compulsory nature of the benefit — assumptions could be made reliably as to the balance of the money being applied by male and female lives respectively, and according to the marital status. However, earlier this year the authorities allowed an element of self insurance to be applied to this market, when they permitted an income drawdown facility to be used for this sector of the market. This development has the potential to alter the assumptions underlying unisex, unistate annuity rates and, in turn, to encourage more potential annuitants to seek the self-insurance route.

Some politicians are promoting the wider application of unisex annuity rates; they do not appreciate the implications that arise due to the availability of alternative vehicles, which, so long as they exist, can undermine the application of sound principles. A few years ago, together with the Institute, we made a submission to the DSS on unisex annuity rates; given recent developments, we should revisit that work.

Another aspect of anti-discriminatory legislation that could have a bearing on our work is the Disability Discrimination Act 1995. Under this Act, regulations have

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been issued whereby it is not possible to discriminate unless there is evidence, including statistics, to support the decision. This will create a 'chicken and egg dilemma'. If discrimination is not permitted, will it be possible to collect the necessary data to support discrimination? What motivation will companies have to collect data today for use tomorrow? Through the Continuous Mortality Investigation Bureau, the actuarial profession has been doing work on impaired lives for some time, and must be prepared to make its voice heard. However, the scope of the Bureau's work is limited to the data it collects from life assurance companies; not only do some companies not contribute, but many who do contribute to only some of the Bureau's investigations. If the data covered 100% of the market, that would increase the credibility of the results even more; it would be in the public interest to make the investigations more comprehensive. I believe that this issue is going to be addressed by the Life Board. However, there is another area where data must be plentiful, but it has not yet been pooled — I refer to large self administered pension schemes. Mr A. Neill drew attention to this issue 5 years ago, but so far there has been only limited progress.

I will now turn my attention to the subject of policyholders' reasonable expectations (PRE). The term first emerged in the Insurance Companies Act 1982 — in the context that the Secretary of State could take action to wind up a company if he believed that the PRE were threatened. The Act did not define what this term meant, nor did it say what steps the supervisory authority should take to satisfy itself on the issue. It was a natural for the Appointed Actuary; GN1 already incorporated a requirement for the Appointed Actuary, in certain circumstances, to draw certain issues to the attention of the supervisor. Furthermore the Appointed Actuary had invariably been the 'conscience' of a life assurance company, in particular in ensuring that a bonus distribution was equitable. However, it was not until July 1992 that a reference appeared in GN1. A paper prepared by a working party was published on the issue. Following fairly wide discussion, it was decided not to formalise any standards for PRE. However, until the term is tested in court, no one is certain what it means. Many of us believe that the effect on PRE must be considered where discretion can be exercised, for example the distribution of surpluses or the increase of charges on policies. Other factors include the prudent management of the company.

It is worthwhile considering similar issues in other areas of financial products. In its report, the Pensions Law Review Committee included a brief section on pension scheme members' expectations. However, it made no specific recommendations in this respect, and there is not a corresponding reference in the Pensions Act 1995.

Another area of financial service products where discretionary action can be taken, although not calling for the involvement of an actuary, is that of bank and building society products, in particular savings and investment accounts, where it is not uncommon for new products to be offered on attractive terms, at the expense of existing investors. I believe that this is frowned upon by their regulators, and although the trade associations representing these movements have taken some action, it is doubtful if their members always act in accordance with their customers' reasonable expectations.

One is left asking the question why life assurance companies are singled out for legislative treatment in this respect? Is it because the supervisors can rely on our members to enforce their rules?

A review, in 1996, of the changing role of the Appointed Actuary cannot ignore some of the consequences of the Financial Services Act 1986 (FSA), in particular our involvement in the disclosure exercise.

Before Professor Gower had started his Inquiry into Investor Protection, policyholders had been given the right, in certain circumstances, to withdraw from a contract without loss. There were few actuarial considerations involved, those where cancellation would potentially involve significant options against the life assurance company, for example short-term assurance policies and immediate annuities contracts, being outside the scope of this cooling-off legislation.

The FSA led to a lot of changes in the methods of marketing life assurance products, many of them involving actuarial input either directly from the profession to the regulators or to the provider by its actuaries. The basis of illustrations was dictated by the regulators, although the members of the Association of British Insurers (ABI) had voluntarily introduced a realistic basis a few years earlier to replace illustrations based on current bonus rates. The basis has changed several times since the implementation of the FSA, partly to reflect falling investment returns against the background of lower inflation, but more significantly to reflect life offices' own expense or charges experience. The adoption of a realistic basis for illustrating prospective benefits was of assistance in managing the reduction of bonus rates that followed the reduction in investment returns triggered by falling inflation.

Another consequence of the FSA was the introduction, in 1990, of the With Profits Guide. This idea had been developed by a working party established by Councils to advise on the information that could be given to prospective policyholders. The Guide has proved useful to commentators, but whether it has achieved the objective of informing the lay public is doubtful; its stereotyped style will not have helped in this respect. It is currently being reviewed, and the profession should make its views known.

Against the background of the disclosure of the effect of expenses, including commission, on policyholders' benefits, I have studied some of the figures published annually by the ABI, to examine what the industry is costing the consumer and what the consumer is offered in return. Membership of the ABI currently accounts for over 95% of the long-term business written by U.K. insurance companies. Figures derived from ABI statistics should be reasonably representative of U.K. companies, although the statistics are not kept in such a format that it is possible to exclude business written overseas. I looked at some of the annual statistics published by the ABI as far back as 1976 — prior to that time companies were not required by statute to disclose the market value of their assets.

As the actuarial profession was involved in the development of the Reduction in

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Yield method of expense disclosure (RIY), I began by compiling the historic figures for the life assurance industry on similar principles, which I describe as the 'expense charge' — being the expenses of management, including commission, together with any transfer to shareholders, expressed as a percentage of the value of the funds under management. This is not strictly comparable to RIY or current expense disclosure, in that it makes no allowance for some items that must be taken into consideration in accordance with GN22, such as the cost of subsidised loans to employees, nor does it take credit for any expenses that could be met out of profits not transferred to shareholders. Whilst the RIY figures disclosed to the consumer relate to the future and are calculated on a policy-by-policy basis, with the costs effectively spread uniformly over the term of the contract, those based on past experience are a snapshot of that year's experience, and, furthermore, are affected by the underlying market conditions; thus in those years with poor investment returns, for example in both 1987 and 1990, the 'expense charges' produced from the ABI statistics would be inflated and conversely. The results of my study would have been distorted by the incidence of new business, but should indicate whether there is a trend, and, when compared with the investment returns achieved, should demonstrate what the life assurance industry gives the consumer in return.

I have produced the results of this exercise, for the years 1976-1994, as a series of charts. Figures for 1995 were not available in time for inclusion in my study. I wish to acknowledge the assistance in this exercise of one of my actuarial colleagues, Mr J. F. Mulligan. Figure 1 shows the 'expense charge', the continuous

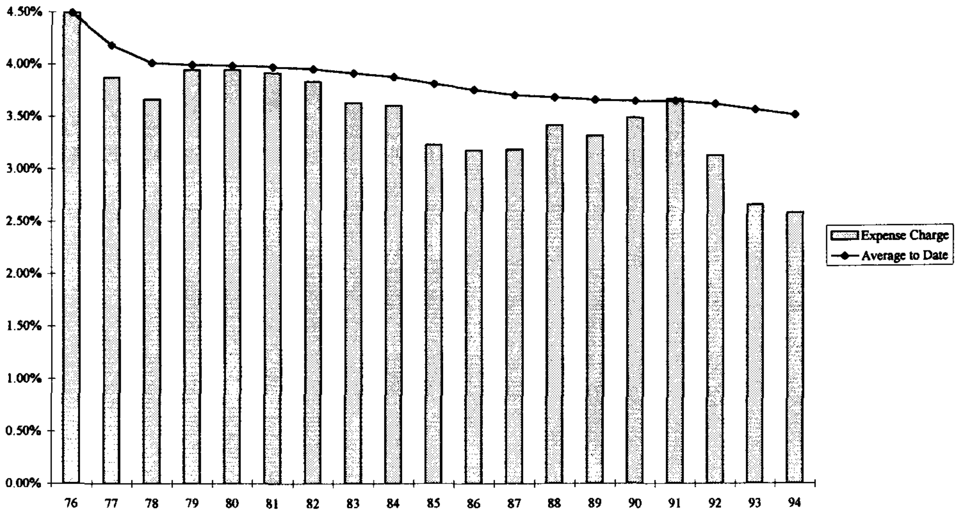

Figure 1. Expense charge for life offices

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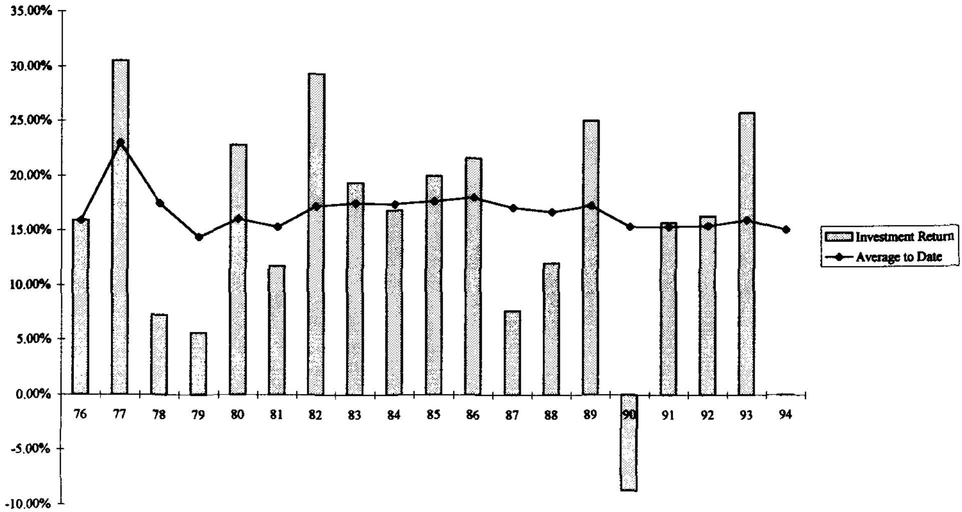

Figure 2. Pre-tax investment return for life offices

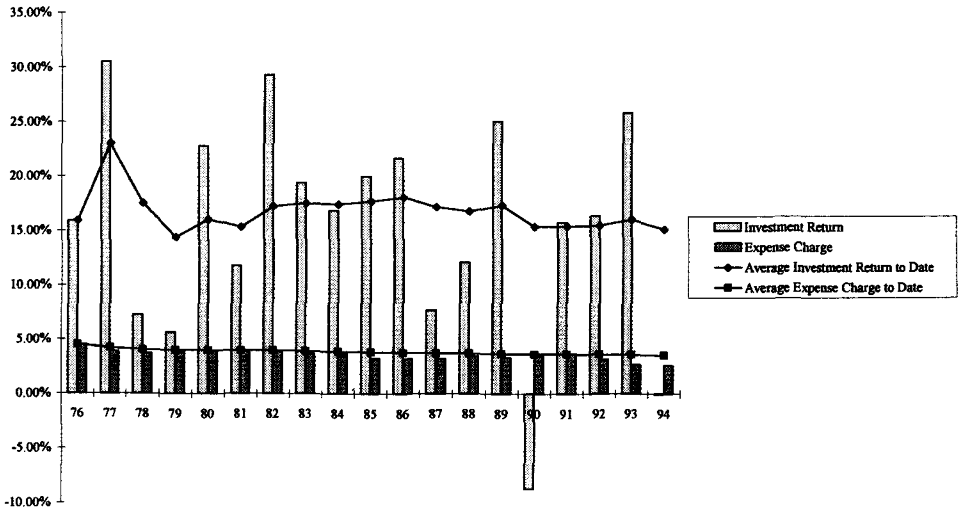

Figure 3. Life offices — expense charge and investment return

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line shows the average for the period from 1976 to each date; the trend was downwards from the period of high inflation in the mid 1970s, but suffered a reversal in 1988/91 — probably linked to the implementation of the FSA — before continuing the downward trend; the 1990 figure would also have been affected by the conditions in the investment markets. The levels of business written in recent years will have contributed to the recent drop, but I believe that other factors are involved, including some benefits from the FSA. I have also calculated the pre-tax investment return achieved on long-term funds over the same period, the results of which are shown in Figure 2; again the continuous line shows the average return from 1976 to each date. These rates reflect market conditions and the mix of assets over time. The figure shows no surprises. Figure 3 superimposes the second on the first. The difference between the two indicates that the life assurance industry gave its policyholders a gross return in excess of 11.5% p.a. over the period studied. During that time U.K. retail price inflation averaged 7.4% p.a., and thus the industry gave a real return, before tax, of over 4% p.a.

I also studied similar figures in respect of another sector of the savings and investment market, namely those for the building society movement. These appear in the *Compendium of Housing Finance Statistics*, published jointly by the Building Societies Association and the Council of Mortgage Lenders. Again, the 1995 figures were not available in time. The pre-tax return achieved by building societies on their investments is shown in Figure 4, again the continuous line gives the average from 1976 to each date. Again there are no surprises — the figures reflect the returns on cash. Figure 5 shows the corresponding 'expense charge' — defined as income foregone by investors, excluding corporation tax. This is more volatile than one might have expected, but the trend is upwards, although I believe that the figure for 1995 may show an improvement due to the decision taken last year by certain building societies to increase the amount paid to investors. However, there was a dip round about 1990, and this occurs at the same time as the chart for life assurance companies 'expense charge' indicates an increase. I suspect that the increase in life assurance commission rates, following the termination of maximum commissions, contributed to the reversal in the figures at that time for both industries. Figure 6 brings the income and expenses together, showing that the gross return payable to the saver net of expenses averaged just under 9.8% p.a., almost 2% p.a. less than the return available from the life assurance companies — despite their significantly higher expenses. Figure 7 compares the expense charges for these two sectors of the savings market — it can be seen that the gap between the two has narrowed considerably.

I realise that my comments on this exercise might warrant some discussion, and hope that issues they raise might be picked up directly or indirectly by the working party established earlier this year by both Councils, to consider the future regulation of financial services. The working party plans to produce a paper for discussion at a Sessional Meeting next year.

The Appointed Actuary system has responded well to these changes, although, perhaps, the most significant was made to the system itself, when, in 1992,

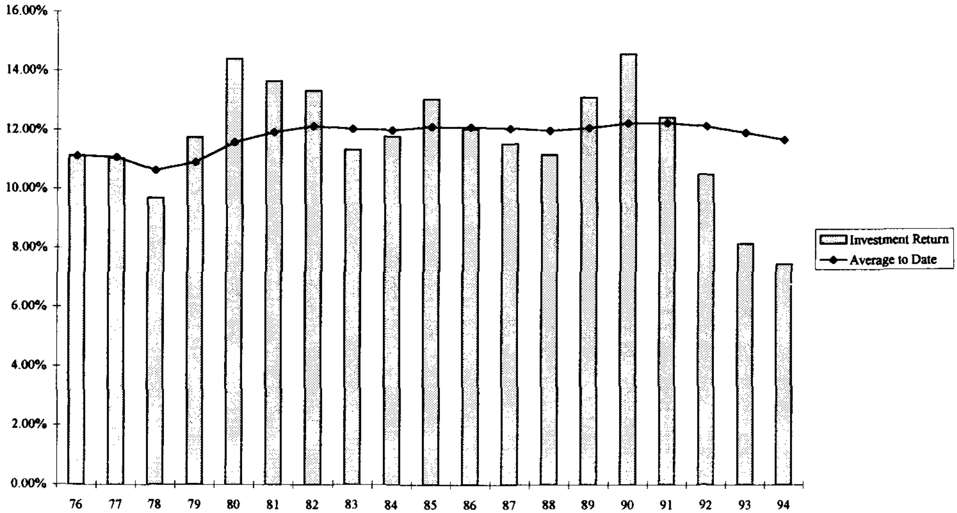

Figure 4. Pre-tax investment return for building societies

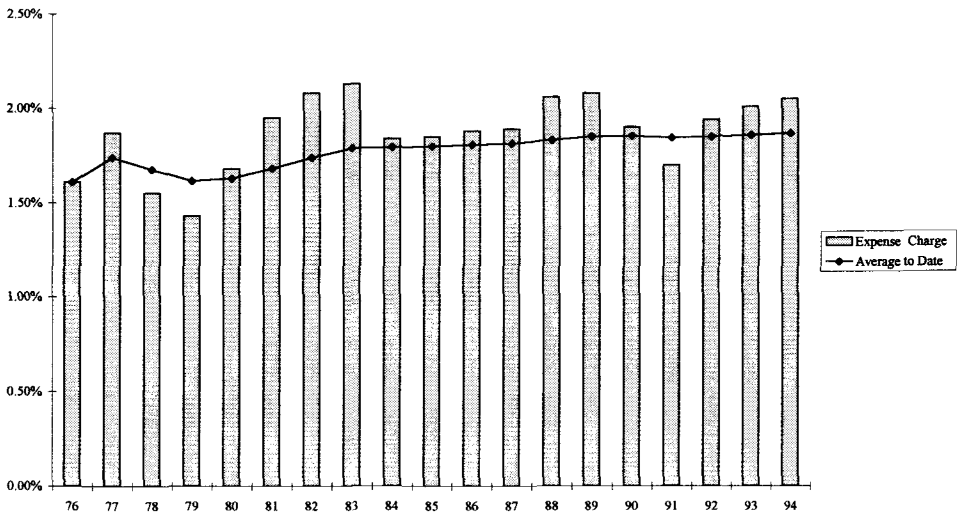

Figure 5. Expense charge for building societies

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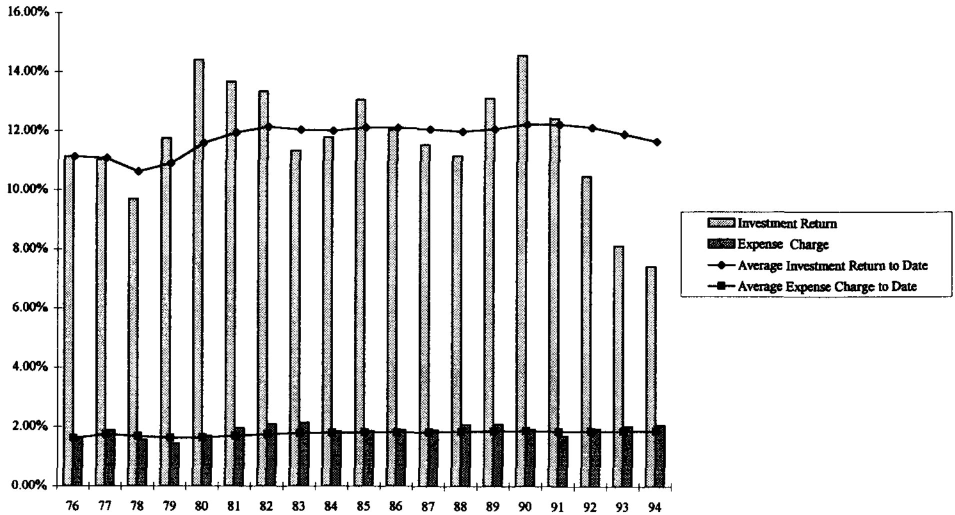

Figure 6. Building societies — expense charge and investment returns

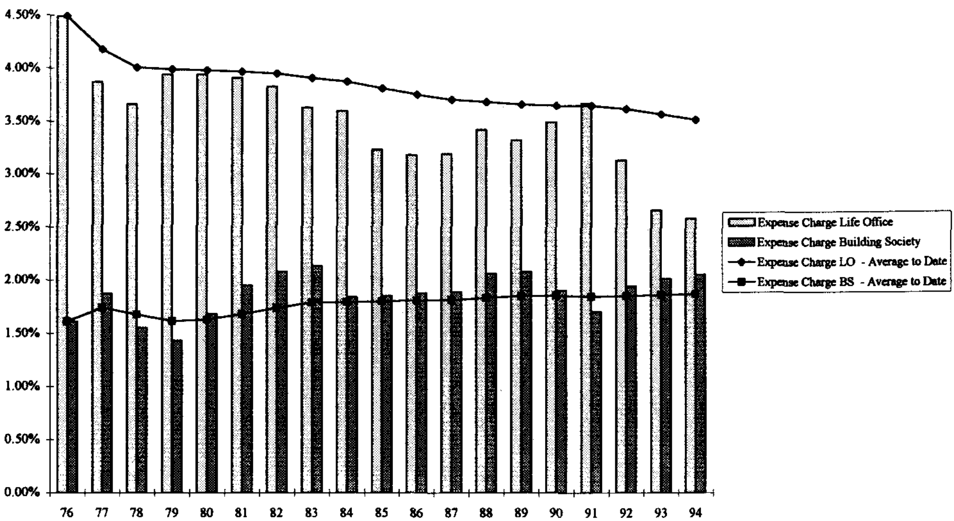

Figure 7. Expense charge — life offices vs. building societies

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practising certificates were introduced, a concept now being extended to Scheme Actuaries. Opportunities are taken to promote the Appointed Actuary system to regulators in other countries, for example via the Groupe Consultatif. It is encouraging that, in the footsteps of the Third Life Directive, Germany has adopted a similar system. The system is, however, not without its critics, both in the U.K. and elsewhere. Critics tend to question how an individual who is an employee can carry out the requisite duties. The profession must maintain its standards if the critics are not to be proved right.

I will now move on from my random wander through some of the changes that have affected the work of the Appointed Actuary and his or her team in recent years to issues affecting all of the profession in the future.

THE FUTURE OF THE PROFESSION

Last session a paper on the Future of the Profession produced by a Task Force established by the President of the Institute and our own President was discussed at various meetings, including the Faculty's November Sessional Meeting.

The paper demonstrated, on a 'best estimate' basis, that there would be an excess supply of actuaries by the year 2005. Furthermore, in order to meet demand in some sectors, many actuaries would have to move to new fields, in particular out of the life assurance sector, where the Task Force forecast considerable over-supply; this will involve an element of retraining. These findings present a challenge to the profession, not only to meet the retraining needs, but also in promoting to the wider public the work of the actuary.

Even before the report was published, consideration was being given to the problem of those who embark on an actuarial career and get so far, but not far enough to qualify. Together with the Institute, we now award a Diploma of Actuarial Techniques to those who have satisfactorily completed the examinations in what some describe as the *actuarial toolbox*. Thus, that group of students should not feel that all their efforts have been in vain. Coincidentally, it also caters for those working in less developed countries, where employers are looking primarily for individuals with the basic skills. It is expected that many recipients of the Diploma will not complete their Fellowship, either because they have no wish to be qualified actuaries or because they are unable to complete the qualification.

Some people qualifying for the Diploma will have passed examinations leading to exemptions in all of the relevant subjects whilst on a full-time university course, whether it be a first degree or post-graduate diploma. Their relationship with the Faculty and the Institute will be more tenuous than that between a university graduate and his or her *alma mater*. We should endeavour to find ways to ensure that individuals who receive the new diploma have a continuing relationship with the professional bodies, even if they do not ultimately qualify as Fellows. It is possible that some of these people might make a contribution, in future, to the work of the Faculty, and such contribution might be recognised, even to the extent of electing the individual to Fellowship.

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Turning to another aspect of the paper on the future of the profession; as already mentioned, it envisages the need to retrain some actuaries to work in areas to which they have not been accustomed. The Task Force also envisaged a combination of soft encroachment and permeation into other areas, with the approval of others already in that field. Many in other professions may consider that this displays an aura of pretentiousness — I think that most of us would disagree. I think that none of us would claim that every actuary has a right to be employed, but I believe that the profession has a duty to its members to create an environment in which the members are able to practise. If there are tasks to be tackled that can use the special skills of an actuary, then, from the profession's point of view, it is better that they are done by an actuary rather than by someone with other qualifications.

In his Presidential Address 26 years ago, Mr D.W.A. Donald, when talking about the need to recruit students, drew attention to correspondence in the *Financial Times* that congratulated accountants on becoming "less concerned about the past and more concerned about estimates for the future. They were moving into fields of management finance". Mr Donald made the point that accountants were moving into the area of expertise practised by actuaries for over a century. It has taken us approximately a quarter of a century to promote an interest in capital projects. Those comments indicate that we, in turn, should not be reluctant to contemplate encroachment — in fact, if we had had the resources we should have done so earlier.

One problem with either encroachment or permeation concerns the current training process, depending, in effect, on suitable employment for actuarial students. Many traditional employers of actuarial students will have carried out their own forecasts, and may already have reduced their demand for suitable students — this may be a factor in the reduced number of student registrations in recent years. The encroachment in the past into the general insurance area was, in the first instance, fed by the individuals recruited by composite insurance companies as actuarial trainees for their life departments. Whilst the future growth of actuaries working in this area may well be fed by students recruited for that area, the same is unlikely to apply to the new areas that we have chosen in recent years to refer to as wider fields, except where they are natural by-products of traditional areas e.g. health care.

If we are to produce the required number of actuaries that would follow even from soft encroachment, there must, I believe, be increased reliance on universities, in particular those with established actuarial departments, such as Heriot-Watt University. Experience has shown that academic actuaries can work well with those from the business world, not only in the education of actuaries, but also in the areas of research. Why should they not also play their part in developing the spread of actuarial work into other areas? In fact, it is the existence of these departments that might act as the catalyst for permeation. There are some who believe that we should cut back on recruitment in order to match the demand from our traditional areas, but this makes no allowance for the actuarial graduates of those universities with actuarial departments — in such a scenario not all their

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graduates with the requisite exemptions will be able to find suitable employment in the traditional areas, leading through to qualification as an actuary; they will, instead, permeate into other fields. Is it not preferable that we should find a way of achieving this permeation under the profession's umbrella? In any event, given the decision to which I have referred, taken last session, to grant a Diploma in Actuarial Techniques to partially qualified individuals, it would seem natural for the universities to take steps to extend their courses to cover the ground required for such diploma. Such extension on the part of Universities assumes that we would grant the Diploma to those university graduates who have reached a satisfactory standard in the various subjects, provided that they register with us as students, i.e. without actually taking any of our examinations.

At the other extreme there are those who favour hard encroachment — but, given the demand forecast by the Task Force, this would imply a radical rethink of the training methods and an even bigger shift towards the involvement of the universities. Would they wish to go down this route with a vocational subject unless there was reasonable certainty that there would be employment for their graduates at the end of the course? However, the scale of recruitment would hardly encourage the development of many new university departments. I am left with the thought that soft encroachment or permeation is not only feasible, but the likely outcome.

A number of contributors at the discussions of the report were critical of the examination regime, introduced a few years ago. It appears to have had an adverse effect on the pass rate, although transitional provisions may have had a part to play in this respect. The syllabus obviously needs to be reviewed regularly, in order to ensure that it remains appropriate for the commercial world in which actuaries operate; it needs to recognise that some techniques that have served actuaries well in the past have been superseded due to technological developments; but the system should still ensure that an actuary is capable of analysing a problem involving uncertainty, and, by applying actuarial techniques, recommend a solution; in so doing the individual must recognise that there will not be a unique solution.

I am not convinced that the current system is achieving this objective. I recall that, in 1992, I was one of the scrutineers of the new educational material for one of the later parts of the examinations, the intention being that the syllabus was determined by the tuition material. I commented at an early stage on the lack of depth presented by the material — there were no references to published papers. One was given the impression of a unique solution; there was little encouragement to look elsewhere. The approach adopted in the past was a casualty of the desire to control the student's workload. The concept of core reading has since been introduced, although whether that has redressed the balance is too early to say.

The Faculty was traditionally opposed to specialisation, believing instead that its members should have a broad grasp of the knowledge and application of actuarial techniques. Would the replacement of part of the traditional examinations with a requirement of the student to produce a dissertation over a reasonable period of time, demonstrating the individual's ability to analyse a problem and recommend a solution, conflict with that tradition?

Whilst research leading to a thesis has been the route adopted for doctorates, many organisations offering first degree or professional qualifications do not rely totally on the traditional examination process — they also seek the preparation of a dissertation involving some research on the part of the student. It should be possible to set realistic problems calling for the application of many of the techniques learnt whilst studying for the earlier part of the examinations. I realise that we would have to guard against the dangers of dissertation agencies springing up — but this should not be insoluble.

THE ORGANISATION OF THE ACTUARIAL PROFESSION

In his Address two years ago, my predecessor, Mr G.M. Murray, initiated a debate within the Faculty about its future. Various ideas were floated at a Sessional Meeting held in March 1995. Against the background of that discussion, a working party, established by the President, developed a possible structure for discussion with the Institute. An outline of the ideas appeared in *The Actuary* ; basically, the intention was to create a structure for the actuarial profession in the U.K. that would enable it to speak with one voice and to spread the costs equitably across the membership, but at the same time retaining the characteristics of the two separate bodies. This proposed structure was rejected following discussion at the joint meeting of the two Councils in Birmingham 12 months ago. That meeting did, however, establish a Steering Group to progress some of the ideas — in particular the establishment of a joint organisation, which could manage the 'day-to-day' affairs of the actuarial profession in the U.K. and speak for the two separate professional bodies on most issues, reducing the time it takes to reach decisions, mainly on submissions to the authorities. Steps taken two years ago to create the various boards, and, in the case of the Institute, a Management Committee, had helped considerably, but it was still necessary to refer some items to Councils for decision. Against this background the 'Faculty and Institute Management Committee' has been established. It is intended that usually a third of the members of the Management Committee will be drawn from our own Council, and it will meet in Edinburgh on several occasions each year. The individual members of Council serve on at least one of the boards or joint committees that report to the FIMC, with Council meeting less frequently to discuss strategic issues and matters appertaining solely to the Faculty.

Another area that the Steering Group addressed was the subject of 'cost savings'; a number of issues were identified where it is thought that costs can be reduced — the most significant being the elimination of duplication of services between London and Edinburgh. This does not mean that nothing will be done from Edinburgh — some services previously offered from both locations will in future be provided solely from Edinburgh.

There remains the question of whether the Faculty should remain an independent body. Quite rightly most of our friends at the Institute consider that it is for the Faculty to decide its future. In the work to which I have referred, a number of us took the view that the members of the Faculty played a major part in the affairs of the U.K. profession, not only in the work of boards and committees, but also in the area of research. Edinburgh is seen, not only within the U.K., but also internationally, as a major centre of actuarial work. It is doubtful whether the actuarial department of Heriot-Watt University would continue to flourish if the actuarial profession in the U.K. was seen to be London based. Without the presence of the Faculty, would Edinburgh continue to attract the quality of papers for discussion at actuarial meetings? Would the discussions at such meetings be recorded for future reference? Although many papers are now discussed at Sessional Meetings of both the Faculty and the Institute, invariably the discussions take different paths and a wider range of points are made than would be the case if the papers were discussed in only one location. Although not always, our meetings seem to encourage more spontaneous contributions.

One must not overlook the role of our employers in this debate. Our work for the profession depends on their support. Many of our members work outside Scotland and a number of those make considerable contributions to the work of the Faculty, but the biggest concentration of our members is in Scotland. Scotland remains a major location for the head offices of U.K. life assurance companies; a number of the life offices formed in recent years by banks and building societies are located in Scotland. Regardless of the ownership, all these companies will wish to influence the conditions under which they operate, and, because actuarial considerations play a major part in these factors, they will want their actuaries to continue to play a part in formulating policy — this would be most easily achieved by the Faculty remaining a distinct body.

In his Presidential Address in 1970, Mr D. W. A. Donald observed that "the Faculty as a whole is greater than the sum of its individual members" and seven years later, in his Address, Mr R. E. Macdonald hinted that he expected structural changes, but was confident that the Faculty's distinctive contribution would continue to be recognised. Whilst cost may necessitate a new structure, I think that both of these comments are as true today as they were when they were made, and that it is important that the character of the Faculty be retained. As I said in my opening remarks, I will do my best to uphold the traditions of the Faculty in these days of change.

Vote of Thanks to the New President, Mr P. H. Grace, B.Sc., F.F.A. from the Retiring President, Mr G. M. Murray, C.B.E., F.F.A.

Ladies and gentlemen, there can be no doubt but that chemistry's loss has been the Faculty of Actuaries' gain, and St. Andrew's University can claim another distinction for their long list and wide range of outstanding graduates.

Amongst the variety of topics which the President has dealt with so ably tonight has been the Report by the Task Force appointed by Chris Daykin and myself on the 'Future of the Profession'. It is ironic that the President, like myself, can be grateful for the missionary work carried out 35–40 years ago by Ian Isles, John Wallace and others, and yet today he and I would be somewhat inhibited in making similar recruitment tours, since we could not be sure that interested students would be able to find employment — a particularly disappointing outlook for Scotland, with its concentrated actuarial employment being in the life assurance sector, which is forecast to have the greatest quantum of oversupply.

Nevertheless, tonight, we have had an Address, a major part of which has dealt with current issues related to our cornerstone specialism of life assurance — and it is difficult to believe that we have an oversupply of manpower in this area when we consider the large number of issues on which the President has charged the profession to carry out further work, such as the valuation of unitised with-profits business, unisex annuities, the ability to apply discrimination when underwriting, policyholders' reasonable expectations, with-profits guides and level playing fields in the provision of financial services — to name but a few. The President is certainly doing his best to take up the slack.

The President has also challenged us with his interesting tables, showing comparisons of life office returns on assets, together with recent trends in the expense of running the business, alongside similar figures for building societies. This should prove to be fertile ground for further research and development work in the months ahead.

But successful research and development can only emanate from a sound base of appropriately taught education. We have heard, tonight, some interesting and challenging ideas on possible changes to our approach to this subject, and they deserve proper consideration, especially at a time when the requirements for what is needed for recognition as a fully qualified actuary are being debated on a worldwide scale.

Whilst encouraging the profession, both south and north of the Border, and in fact wherever actuaries are to be found, to follow a policy of soft encroachment into other areas of work, the President has highlighted the contribution which the

Faculty has made in this regard since its founding, and pledged himself to uphold the Faculty's traditions in these times of change, when it is so important that it retains its distinctive character.

I think that it says much for the Faculty that our current President and his three immediate predecessors have come from such a broad spectrum of our specialisms — life, pensions, investment and acadaemia — and with the current Chairman of the General Insurance Board and his predecessor also being Faculty Fellows, we have strong representation in all the main practice areas of our profession. Long may this continue.

You have already shown your appreciation, but I ask you now to join me in acknowledging once again a most worthy and challenging Presidential Address, to extend to Paul Grace our congratulations, and to pledge our support to him during what will be a strenuous term of office for one year as Chairman of the Faculty and Institute Management Committee and for two years as our President.

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